TENNESSEE DEPARTMENT OF FINANCIAL INSTITUTIONS

Report to the Tennessee General Assembly, Pursuant to Public Chapter 440, Acts of 2005, Section 7(e)

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Introduction

Public Chapter 440 of the Acts of 2005 significantly amends the Tennessee Title Pledge Act ("Act"), set forth in Title 45, Chapter 15, regarding the operation and regulation of the title pledge industry. Specifically, Public Chapter 440 subjects the title pledge industry to licensing and examination by the Department of Financial Institutions ("Department").

Public Chapter 440 did not change T.C.A. Section 45-15-111, the provisions in the Act governing the rate of interest and fees which a title pledge lender can charge a borrower. Under T.C.A. Section 45-15-111(a), a title pledge lender can charge a borrower an effective rate of interest not to exceed 2% per month. Additionally, T.C.A. Section 45-15-111(a) authorizes a title pledge lender to assess a borrower a "customary fee" to defray the costs of operating a title pledge office. This fee must not exceed one-fifth of the amount of the original principal amount of the title pledge agreement.

Although Public Chapter 440 did not amend the provisions governing the rates of interest and fees, Public Chapter 440, specifically in Section 7(e), requires the Commissioner of the Department to make a written report to the General Assembly by February 1, 2006, containing at a minimum "an analysis of the rates and terms of title pledge loans and the reasonableness and appropriateness thereof." Public Chapter 440, Section 7(e), goes on to provide that, commencing July 1, 2005, the Commissioner shall have full access to all records of all title pledge lenders for the sole purpose of making the written report. In order to comply with this statutory directive and provide an analysis of the reasonableness and appropriateness of the rates and terms, the Department has reviewed the practices and certain financial information of the title pledge industry**.**

The Department issues the following report.

Highlights of Amendments to the Tennessee Title Pledge Act

Amendments to the Act **<u>effective July 1, 2005</u>** include:

- Provides the Commissioner of the Department with the authority to have full access to all records of a person engaged in the business of title pledge lending for the sole purpose of making a written report to the general assembly no later than February 1, 2006. The scope of this report shall be within the discretion of the Commissioner, but shall at a minimum include an analysis of the rates and terms of title pledge loans and reasonableness and appropriateness thereof.

Amendments to the Act **<u>effective November 1, 2005</u>** include:

- Requires all title pledge lenders to submit to the Department a completed application with required supporting documentation along with a license fee in an amount prescribed by the Commissioner by rule, but not to exceed $800.00, per location.
- Requires applicants to provide financial statements, prepared by a Certified Public Accountant not affiliated with the applicant, showing a tangible net worth of not less than $75,000 for each location.

- Requires applicants to submit a $25,000 bond or letter of credit per location, capped at $200,000 for a single title pledge lender.
- Requires borrowers to pay a principal reduction of 5% of the original principal amount of the title pledge agreement beginning with the third renewal. Requires that title pledge lenders calculate interest and fees at each successive renewal on the outstanding principal balance. Allows the title pledge lender to defer any principal reduction payment until the end of the title pledge agreement.
- Provides borrowers with a one day right to cancel the title pledge agreement. Requires that the sale of repossessed pledged property be made in a "commercially reasonable" manner as defined by the Uniform Commercial Code, and that any surplus from the sale be remitted to the borrower.
- Authorizes the Commissioner to charge actual expenses for examination(s) of licensees.
- Grants the Commissioner subpoena power and the right to assess civil money penalties, issue cease and desist orders and require refunds to customers.
- Grants the Commissioner the authority to suspend or revoke a license or suspend or bar individuals from the industry for violations of the Act.

Limitations on Information

Limited information was available due to the time frame given to the Department to make this report. Additional information, such as the information outlined below, would most certainly impact an analysis of the reasonableness and appropriateness of the rates and terms. However, at this time, the extent of that impact is unknown.

- Amendments to Act, Effective November 1, 2005

  The majority of the amendments to the Act became effective November 1, 2005. Thus, the Department simply has no information available, at this time, to determine the effect these amendments will have on the practices and profitability of the title pledge industry. The following are some of the amendments which are likely to have the most significant impact on an analysis of the reasonableness and appropriateness of the rates and terms.

  - 5% principal reduction

    Under Public Chapter 440, Section 10, the borrower is required to make a 5% principal reduction beginning with the third renewal of the title pledge agreement and the title pledge lender is required to reduce the outstanding principal balance subject to interest and fees by 5% per month whether the payment is received or not. This amendment will likely decrease both the term of the title pledge agreement and the amount of interest and fees paid by the borrower over the life of the title pledge agreement. However, this principal reduction requirement will take effect for the first time in February, 2006, which constitutes the third renewal for title pledge agreements entered into on or after November 1, 2005. Thus, for purposes of preparing this report, there is no information available on the impact of principal reduction on profitability and, consequently, the reasonableness and appropriateness of the rates and terms.

- “Commercially Reasonable” sale

  Public Chapter 440, Section 11(b)(2) requires that a title pledge lender sell repossessed pledged property in a “commercially reasonable” manner as defined by the Uniform Commercial Code, and that any surplus from the sale be remitted to the borrower. There was no requirement under prior law that a title pledge lender even sell repossessed pledged property, let alone return any surplus from a sale to a borrower. No doubt, this requirement will impact profitability to some extent and, therefore, an analysis of the reasonableness and appropriateness of the rates and terms.

- Regulatory costs

  The 2005 amendments impose certain operational and regulatory costs. The impact on profitability of these increased costs cannot be measured at this time. These costs include:

  · Application fee up to $800.00 (v. $50.00 through County Clerk)

  · Annual license renewal fee up to $800.00

  · Tangible net worth of not less than $75,000 per location

  · Bond requirement ($25,000.00/location, capped at $200,000.00) based on the Department’s estimates: average bond cost is $150.00 per $25,000.00 of coverage/year ($375.00/location for three-year bond)

  · Preparation of compiled financial statement by C.P.A. not affiliated with the applicant

  · Actual and reasonable examination costs which presently amount to $275.00/ per examiner/per day

  · Other operating costs (i.e., recordkeeping, amended title pledge agreements to include required disclosure language)

- Compliance Examinations

  The information-gathering process revealed that some title pledge lenders were charging borrowers fees which were and will continue to be impermissible under the Act. Thus, compliance examinations and enforcement of the law by this Department will certainly to some extent affect the future profitability of those title pledge companies violating the law.

- Financial Information Submitted with License Applications

  Public Chapter 440, Section 5, requires that the application for a title pledge lender license be accompanied by a balance sheet and income statement prepared in accordance with generally accepted accounting principles. The section of this report titled “Summary of Industry Financials” includes a summary of the financial information submitted by applicants for licenses. However, the financial information summarized only reflects the financial information of those applicants who had submitted completed applications to the Department as of January 27, 2006. Moreover, the financial information submitted by applicants represents the financial position of the applicants prior to the implementation of the amendments. And, in some instances, the financial information includes income unrelated to the title pledge business for companies operating multiple types of business as well as income from multi-state title pledge operations.

It should be noted that Public Chapter 440, Section (8)(c), does require that, beginning October 1, 2007, and every odd numbered year thereafter, each title pledge lender file a report with the Commissioner which shall include, but is not limited to, the following:

·Balance sheets

·Statements of income

·Other statistical information that the Commissioner may require for the purpose of determining the general results of operations (Types of information which the Commissioner has required pursuant to similar statutory authority for industrial loan and thrift companies [T.C.A. Section 45-5-503] and deferred presentment services companies [T.C.A. Section 45-17-109] include such information as: average net receivables, rate of return, number of accounts outstanding, bad debt expense including charge-offs, collections on accounts previously charged off and additions to reserve for bad debts.)

Section 8(c) goes on to require that the Commissioner submit to the Governor and General Assembly a summary of the information contained in these reports. The type of information included in this sort of report will, no doubt, provide more comprehensive financial information and operating statistics.

Information-Gathering

- **Information-Gathering Process**

Immediately after close of the 2005 legislative session, the Department began the process of gathering information in order to prepare this report. Initially, the Department contacted the county clerks in all 95 counties in Tennessee in an attempt to determine the number of title pledge business locations in Tennessee. Based upon information obtained from the county clerks, the Department determined that there were approximately 931 title pledge business locations.

The Department prepared an information-gathering survey to identify the characteristics of the title pledge industry such as background, financial, and operational data. Specifically, this survey requested historical information from title pledge lenders such as information on:

- the ownership and organization of title pledge companies
- net worth
- loan amounts, loan rates, loan fees, terms of loan agreements
- additional charges (i.e., late fees, NSF charges, lien recording fees)
- repossession practices

The Department mailed to each of the 931 locations an introduction letter highlighting the upcoming changes to the Act, an invitation to an informational workshop in their area, a copy of the amendments to the Act, and a copy of the information-gathering survey with instructions to complete and return it to the Department by August 1, 2005. 187 title pledge lenders responded by mail to the Department's information-gathering survey. The Department prepared a schedule to visit on site those title pledge lenders that did not respond by mail.

During the full month of August and part of September 2005, the Department dedicated 100% of its Compliance Division examination staff of thirty-two (32) examiners to on-site information-gathering visits of those title pledge lenders that did not respond by mail. This process consisted of one examiner visiting a title pledge location unannounced and completing the information-gathering survey with staff of the title pledge company. In addition, examiners reviewed title pledge agreements, the rates and fees charged and other available records.

In aggregate, the Department received information from 894 title pledge locations, representing about 293 companies. Of the 894 locations contacted, 707, or (80%), were on-site visits with title pledge lenders and 187, or (20%), were information-gathering surveys submitted by mail. The difference between the 931 locations reported by the county clerks and the 894 identified by the Department (37 locations) was accounted for by those companies that were either already out of business, or indicated they would be going out of business due to additional requirements of the amendments to the Act.

- **Summary of Information-Gathering**

The information-gathering process indicated that title pledge lenders charged from 10% per month to 30% per month for title loans, versus the 22% per month that is allowed by law. About 27 companies were found to be charging less than the 22% maximum per month. The average rate among these companies at that time was 18.8%. About 4% of title pledge lenders charged different rates to different customers. However, the majority charged 22% per month for title pledge loans.

The following table provides a summary of the information gathered relating to rates and fees, amounts and terms.

Summary of Information Relating to Rates and Fees, Amounts and Terms			
	On-Site Visits	**Mail-In Surveys**	**Total**
Total Responses	707	187	894
% of Total	80%	20%	--
Number of contracts in 2004	**150,369**	**100,224**	**250,593**
Monthly Interest and Fees			
Minimum	10%	10%	--
Maximum	30%	25%	--
Average	*21.5%*	--	--
Maximum Allowed by Statute	**22%**	--	--
Amount Loaned			
Minimum	$10.00	$20.00	--
Average Minimum	*$115.00*	--	--
Maximum	$5,800.00	$4,000.00	--
Average Maximum	*$1,089.60*	--	--
Maximum Allowed by Statute	**$2,500.00**	--	--
Number of Times Renewed			
Minimum	-0-	-0-	--
Maximum	40	105	--
Average	*7*	--	--
Number of Days from Loan Start to Loan Payoff			
Minimum	1	1	--
Average Minimum	*18*	--	--
Maximum	3,747	1,341	--
Average Maximum	*360*	--	--

The information gathering process indicated that, in addition to the interest and fees specified by law, about 27% of the title pledge lenders charged borrowers unauthorized fees. These fees included: late fees, NSF charges, additional interest, lien recording fees, repossession fees, application fees, renewal fees, trip charges and storage fees.

The information-gathering process also provided information on repossession practices in the industry. Approximately 60% of reporting title pledge lender locations repossessed vehicles as an ordinary business practice in 2004. In addition, there were a total of 17,313 repossessions in 2004 related to the title loan business. Furthermore, approximately 50% of title pledge lender locations reported write-offs due to default. The following table provides a summary of the information gathered regarding repossession and write-off practices.

SUMMARY OF REPOSSESSION AND WRITE-OFF PRACTICES *(based on responses from 894 title pledge locations)*		
Repossessions		**Summary**
# of locations reporting repossessions	539	60% of 894 reporting locations
# of repossessions	17,313	7% of 250,593 title pledge agreements in 2004
Avg. cost of repossession	$92.10	--
Avg. # of days held before sale	43	--
Avg. cost of storage	$72.05	--
Avg. sale price of sold vehicles	$451.46	--
Avg. cost of advertisement	$4.02	--
Write-offs**		
# of Locations reporting write-offs	447	50% of 894 reporting locations
Total # of write-offs reported	20,844	8% of 250,593 title pledge agreements in 2004
# of write-offs due to bankruptcy	1,791	.7% of 250,593 of title pledge agreements in 2004
Dollar value of write-offs	$13,026,981	$624.97 average write-off

*******Uncollectable accounts are accounts that are past due and may be subject to repossession. Companies may decide to write-off these accounts. The timing of write-offs is determined by internal company policy.*

Summary of Industry Financials

Beginning on November 1, 2005, title pledge lenders began making application with the Department. The application requirements include, but are not limited to, a net worth requirement of $75,000 per location and submission of compiled balance sheets and income statements prepared by a Certified Public Accountant not affiliated with the applicant. As of January 27, 2006, 197 title pledge lenders made application with the Department, representing 602 locations throughout Tennessee. Of these 197 applications, 62 companies (representing 115 locations) did not submit the appropriate bond/letter of credit, complete financial statements, or are still under review for other reasons. As such, the financial information that follows only includes the 135 companies (representing 487 locations) making complete application to the Department as of January 27, 2006.

Of the 135 completed applications received, 105 companies (78%) reported positive net income and 30 companies (22%) reported negative net income for their most recent fiscal year. The top five companies, based upon the total number of title pledge agreements entered into in 2004, accounted for 28% of all title pledge agreements entered into in 2004. These same five companies account for 20% of locations making application for a title pledge license. The average net income for these five top companies is approximately $95,000 per location.

The following table provides a summary of financial statement items for each title pledge location represented by a complete application with the Department. For companies with more than one location, financial information is presented on a per location basis so that they may be compared with other companies. **However, it must be noted that a majority of companies are believed to be engaged in multiple lines of business and the net income averages stated below cannot be attributed solely to the title pledge business.**

CONSOLIDATED FINANCIAL STATEMENT SUMMARY (Based on 135 companies, representing 487 title pledge locations)			
	Assets	**Liabilities**	**Net Worth**
Max	**$2,262,081.80**	**$1,728,761.15**	**$1,265,849.00**
Min	**$75,031.92**	**$0.00**	**$75,031.92**
Average	**$237,616.81**	**$57,788.44**	**$179,834.04**
	Revenue	**Expenses**	**Net Income**
Max	**$1,802,395.30**	**$1,721,312.14**	**$294,014.41**
Min	**$1,489.46**	**$2,852.00**	**($90,620.00)**
Average	**$209,741.36**	**$171,966.16**	**$37,775.21**

State-to-State Comparison of Title Pledge Regulation

The Department, in February 2005, created a questionnaire regarding nationwide title pledge regulation and asked the National Association of Consumer Credit Administrators ("NACCA") to forward the questionnaire to their national membership. In response, the following thirteen states provided information to the Department regarding title pledge regulation in their states: Alabama, Florida, Idaho, Kentucky, Mississippi, Missouri, Montana, New Hampshire, North Carolina, North Dakota, Oregon, South Carolina, and Utah. Of these states, Alabama had the highest number of title pledge lenders, 997 locations, and Florida and Kentucky had the fewest number of title pledge lenders with zero locations.

The states varied in their regulatory requirements for title pledge lenders. In regards to interest and fees, Florida and Kentucky impose caps on the interest and fees at 30% per year and 36% per year, respectively. There are no title pledge lenders in those two states. On the other hand, Missouri, New Hampshire, and Oregon allow the lender and borrower to negotiate the interest and fees for the title pledge loan.

The following tables summarize information obtained from these states pertaining to terms of title pledge agreements and costs of licensing requirements. Because the North Dakota Department of Financial Institutions informed the Department that title pledge companies are illegal in their state, North Dakota is not included in these tables.

TERMS OF TITLE PLEDGE AGREEMENTS**						
	INTEREST RATE	**FEES**	**Max. Loan Amt.**	**Term**	**PRINCIPAL REDUCTION**	**Repo. Provisions / Surplus**
TN	2% per month	1/5 of the original principal	$2,500	30 days, may renew.	Beginning with the third renewal, each renewal must include a 5% principal reduction	Repossession. 20 day holding period. Sale in a commercially reasonable manner. Surplus to borrower.
AL	25% per month	None	No cap	30 days	N/A	If customer does not renew, then repossession occurs. No notice. Lender keeps surplus.
FL	30% per annum up to $2,000 24% - $2,000+ to $3,000 18% - $3,000+	N/A	No cap	30 days, may extend	N/A	30 days after notice. Surplus to borrower.
ID	Becomes title pledge loan at 36% per annum	N/A	$2,000	30 days, may extend	N/A	Notice. Surplus to borrower.
KY	36% per annum	N/A	$4,000	30 days / 3 renewals	N/A	Repossession. 20 day holding period. Notice to borrower. Surplus to borrower. Sale in commercially reasonable manner.
MS	25% per month	N/A	$2,500	30 days, may renew	10% principal reduction each month	Repossesses at point of default. 85% of surplus to borrower.
MO	No cap	N/A	$5,000	Installments	After third renewal, at least 10% principal reduction	Send customer 30-day notice. Surplus to borrower.
MT	25% per month up to $2,000 18% - $2,000+ to $4,000 10% - 4,000+	Lien recording fees, NSF charge, but no damages	No cap	30 days, may renew	Beginning with 6th renewal, at least 10% principal reduction	Surrender vehicle, no deficiency balance.
NH	No cap	1 NSF fee / check	$10,000	30 days / 11 renewals	5% principal reduction in addition to any finance charges accrued in order to renew.	No rules at this time.
NC	Loans subject to Consumer Finance Act 36% per annum	5% or $25 processing fee	$3,000	N/A	N/A	N/A
OR	No cap	N/A	No cap	Up to 60 days / 6 renewals	Renewals capped at 6. After that time, no more interest accrues and payments are made against principal.	Written notice 10 days after default. Repossesses on the 11th day. Surplus to borrower, deficiency obtained through collection.
SC	25% per month/ 300% per year	N/A	$7,500	30 days / up to 6 renewals	N/A	Repossesses at point of default. Surplus to borrower.
UT	No cap; average 360%	NA	No cap	May renew	N/A	None. After 30 days the lender has the choice of repossession, sending to collection agency, or file civil charges. No deficiency balance.

***Note that this information represents information received from state regulators of the states listed above and is current as of February 18, 2005*

COSTS RELATING TO LICENSING REQUIREMENTS**						
	LICENSED LOCATIONS	**LICENSE APPLICATION FEE**	**LICENSE RENEWAL FEE**	**RENEWAL FREQUENCY**	**BONDING REQUIREMENTS**	**NET WORTH REQUIREMENTS**
TN	214 as of Jan. 27, 2006	$700 per location/year/inclusive of investigation fee	$700 per location/year	Biennial / Fee is annual	$25,000 per location not to exceed $200,000	$75,000 per location
AL	997	$150 per location	$100 per location	Annual	N/A	N/A
FL	-0-	$1,200 registration fee plus $200 investigation fee	$1,200 per location plus a $600 reinstatement fee if license lapses	Biennial / even years	$100,000 plus $100,000 per location not to exceed $1 million, or a letter of credit	N/A
ID	119 with an additional 219 eligible	$114 per location	Base fee is $14, plus a tax of $10 per $100,000, or part thereof, of Idaho consumer accounts receivable on the licensee's books on December 31. The first $100,000 is excluded, so most pay $14	Annual	None. Must show $30,000 available for lending	N/A
KY	-0-	$500 per location	$500 per location	Annual	$100,000	$100,000 per location
MS	295	$750 per location	$475 per location	Annual	$50,000 per location, not to exceed $250,000	N/A
MO	250	$1,000 per location	$1,000 per location	Biennial	$75,000 bond; $20,000 / location; liability insurance of $1 million	N/A
MT	N/A	$500 / $250 if less than 6 months remaining in year	$500 per location	Annual	$10,000 per location	N/A
NH	63 (payday and title)	$450 per location	$450 per location	Annual	$25,000 cash available for loans or $25,000 surety bond	$25,000 or higher surety bond
NC	N/A	$250	$250	Annual	N/A	$50,000 per location
OR	58	$520	$520	Annual	None	None
SC	175	$300 per location	$300 per location	Annual	None	$25,000 liquid assets
UT	180	$300	$100	Annual	None	N/A

***Note that this information represents information received from state regulators of the states listed above and is current as of February 18, 2005*

Summary

In order to provide comment on the reasonableness and appropriateness of rates and terms, the Department has sought to provide a snapshot of industry profitability and practices. The financials provided by the industry, through the application process, reflect the results of operations prior to the November 1, 2005 implementation of the amendments and do not take into consideration the impact that the amendments to the Act will have on profitability. In addition, this financial information consisted of multiple lines of business and cannot be attributed solely to the title pledge business. Because 2006 is the initial year of comprehensive regulation of the title pledge industry, this report is preliminary and reflects an industry in transition. Operational information was gathered on 894 locations representing about 293 companies. However, about 197 companies representing 602 locations made application for licensure by January 27, 2006. This report might also be considered a benchmark against which future financial performance and operational data may be compared.

Future analysis should indicate the effect of heightened regulation on the profitability of the industry and the reasonableness of rates and terms. For instance, because the Department's examinations revealed the collection of unauthorized rates and fees, simple industry compliance and the enforcement of existing law will affect future profitability.

Financial statements from the application process reflect a diverse industry and a wide range of profitability. While there are companies that report in recent data to either be unprofitable or marginally profitable, there are some companies that appear to be producing significant net income as compared to the rest of the industry. Despite an increase in operational and regulatory costs pursuant to the 2005 amendments that might affect the viability of marginal companies, it may not be unreasonable to speculate that the most profitable title pledge lenders in Tennessee will continue to produce relatively significant net income and perhaps even increase income should competition continue to narrow. It is possible that these companies will command an ever increasing marketplace share of available business. The Department found that at least 13 companies that have submitted application for licensure were charging rates below the maximum amount of 22% per month. The lowest rate was about 10%. This would appear to indicate that, at least for those 13 companies under prior law, the 22% rate was not required in order to operate a title pledge business.

The coming year will bring full compliance examinations and, in October of 2007, a comprehensive report from the industry will be provided the Department as mandated by law which will include more comprehensive financial data and operating statistics. At that time, the Department will have additional information from which to further comment on the rates and terms of title pledge loans. The Department will make this information available to the General Assembly.